Housing Financial Fund

Financial Statements 2013

These Financial Statements are translated from the original statements which are in Icelandic. Should there be discrepancies between the two versions, the Icelandic version shall take precedence.

Housing Financing Fund
Borgartúni 21
105 Reykjavík

Reg.no. 661198-3629

Contents

Endorsement and Statement by the Board of Directors

The Housing Financing Fund ("the Fund") has its headquarters in Borgartún 21, Reykjavik. The Fund's objectives are to provide housing loans, loans for new constructions and property development in Iceland. The Housing Financing Fund is an independent institution owned by the State.

Performance in the year 2013

According to the income statement, loss on the operations of the Housing Financing Fund during the year 2013 amounted to ISK 4,354 million. The Fund's interest margin remained unchanged in the year 2013. Equity at year-end amounted to ISK 14,845 million according to the balance sheet, including an increase in contributed capital at year end by ISK 4,500 million (cf. Note 2). The Fund´s equity ratio, which is calculated on the basis of Regulation no. 544/2004 on the Housing Financing Fund, is 3.4%. The ratio is calculated in the same way as for financial institutions. The Fund´s long-term goal is to maintain an equity ratio over 5.0% and discussions with the authorities aim at complying with the provision of the regulation thereon.

At year end, loans amounted to ISK 768,481 million and decreased by ISK 10,615 million during the year. The Fund's borrowings amounted to ISK 848,102 million and decreased by ISK 13,263 million during the year as the Fund did not seek funding from the market because of its strong liquidity position.

The amount of ISK 3,536 million is recognised among loans to banks in the balance sheet (cf. Note 9) at year-end 2013 due to receivables from former commercial banks resulting from bonds and derivative agreements due to their collapse in October 2008. At the same time, the Fund recognises liabilities to these banks in the amount of ISK 7,317 million due to derivative contracts. In the financial statements it is presumed that the Fund has the right to off-set these balances but uncertainty prevails over the settlement of claims and derivative contracts. However, the courts of law have not yet reached a final conclusion on the Fund's right to off-sets.

Development of defaults and impairment

The quality of the loan portfolio at year end is similar to that at the beginning of the year in terms of the extent of default in the overall portfolio but worse in terms of the age of defaults. Defaults in the loan portfolio peaked in July 2012 but have been decreasing. The increase in real estate prices between years has on the other hand strengthened to some extent the position of underlying collaterals of the loan portfolio. Provisions of impairment are increased in the year 2013 due to the risk in the Fund´s loan portfolio stemming from the rights of borrowers with payments difficulties, such as specific debt and payment adjustments. The impact of the impairment on the Fund´s performance amounted to ISK 5,687 million during the year.

Properties held for sale are recognised at the lower of cost upon repossession or fair value. The methodology leads to the total of the Fund's properties held for sale being recognised at a lower value than the estimated fair value of the same properties according to a valuation amounting to around ISK 2,264 million. The carrying amount of properties held for sale at year-end 2013 amounted to 87% of the official property value of the underlying asset portfolio, which is a more cautious valuation than in previous financial statements.

Operations in the year 2013

Operating results for the year 2013 are mainly affected by extensive work related to processing of customers' debt difficulties, operation of properties held for sale, prepayment risk, declining lending and the effects of impairment. The number of employees during the year 2013 was 100. Salary expenses increased by 18% between years, which is mainly explained by the increase in the number of employees, by the new tax on financial activity levied on the salaries of financial and credit institutions, in addition to the effects of wage increases according to union contracts. Other operating expenses remained mostly the same despite the increase in the number of employees, except for operating cost of properties held for sale, which increased parallel to the increase in the number of properties.

Endorsement and Statement by the Board of Directors contd.

In 2013, the Board confirmed the Fund´s policy of achieving full operational sustainability no later than the year 2018. The plan of operations for the year 2014 is to strengthen the Fund´s infrastructure focusing on risk management and a change in financing the Fund´s loans. Preparation for new funding categories of inflation indexed and non-indexed is completed and issuance by categories will be determined by liquidity and authorizations from the government.

The investigation of the Housing Financing Fund, established by the Congressional resolution approved 17 December 2010, ended in June 2013. The committee´s role was to investigate the activities of the Fund from the beginning of 1999 when the Fund commenced operations. Significant findings were made in the report on various aspects of the Fund's operations. The most serious findings involved the changes made to the financing of the Fund in 2004 with the introduction of non-callable HFF bonds instead of callable housing bonds. The Fund did not have the opportunity to comment on the substance of the report before its publication. Parliament´s Constitutional and Supervisory Committee has recently submitted conclusions which include criticism of the Investigation Committee´s main findings and claims made in the report regarding the Fund.

The Fund was cited for violation of the Act on Consumer Credit, challenging the legality of granting indexed loans in the fall of 2013. The action is based on the Fund not having the authority to collect the costs entailed by the CPI-indexation of the loan as total borrowing costs were not identified in the initial loan process. The Fund requested a motion for dismissal on the grounds of failure to state a valid claim and is currently awaiting the outcome of the District Court dismissal case. It should be noted that previous litigation by the same parties on the same issue was dismissed by the court in April 2013.

On 1 November new laws on consumer credit came into effect. Subsequently new loan terms were implemented, 40 year mortgage loans with a fixed interest rate throughout the term of the loan on the first mortgage, excluding interest review. Due to the Fund´s position, the Government has not authorized the Fund to offer non-indexed loans.

The government announced at the end of November plans for principal reductions of mortgages for households. Indexed mortgage loans will be reduced. Deductions will be made of earlier measures of reductions benefited by borrowers. Fund managers expect full compensation for the loans that are written down, however implementation of the compensation plan has not been finalized.

Establishment of a rental company

The rental company Klettur ehf. was established on 23 January 2013 and the Board of Directors of the Fund agreed to transfer a the Fund's repossessed properties to the company. In selecting the assets, consideration was given to the suitability of the assets as long-term rentals and the location of the properties in markets with demand for such housing, Furthermore a prerequisite for the selection of assets was to meet the primary objective as to rental profitability to insure the future sustainability of the rental company. There are expectations that the establishment of the company and the prospect of selling the company, will facilitate the reduction of the number of foreclosed properties owned by the Fund, as the Fund has only temporary authority to operate the company. At the start of the new fiscal year 2014 the Company sold 517 properties to Klettur ehf.

Financial risk

The main risk factors of the Housing Financing Fund are credit risk, liquidity risk, interest rate and inflation risk, duration imbalance between assets and liabilities, prepayment risk, refinancing risk and operational risk. The Fund's prepayment and refinancing risk is related to an increase in the settlement of loans by the Fund's customers due to changes in the housing loan market. Counterparty and currency risk are also considered to be among the Fund´s financial risks. Repossessed properties have become a major risk in the Fund´s operations due to among other factors the uncertainty of the timing of the sales of some of the properties.

Endorsement and Statement by the Board of Directors contd.

There is serious doubt as to the Fund's future role and its ability to continue as a going concern and this volatile state has existed since the Social Affairs and Housing Minister appointed a project committee on the future organization of housing policy on 9 September 2013 in accordance with the resolution on the action plan for household debt relief passed by Parliament last spring. The project management will submit to the Minister proposals for the future role of the Fund in April or May 2014. As a result, strategic decision-making in the immediate environment of the fund has been suspended, affecting the operations of the Fund in various ways.

Goverance

The Fund operates in accordance with the Housing Act no. 44/1998 and is subject to supervision of the Financial Supervisory in Iceland and abides by the rules of the stock exchange as an issuer of listed bonds.

Following each general election the Minister appoints five members and five reserve members on the Board of Directors of the Fund for a four year term. The Chairman and Reserve Chairman of the Board, appointed by the Minister among board members, shall however be appointed for the same period of office as the appointing Minister. The current Board of Directors was appointed at the end of September 2013.

Board of Directors

The Board of Directors of the Housing Financing Fund places emphasis on maintaining good governance. The Board of Directors has established detailed working procedures for the Board wherein its competences are defined. The Board hires a CEO. The Board of Directors meets with the Fund's auditors on a regular basis and receives copies of minutes of the audit committee´s meetings. The Icelandic National Audit Office decides on the external audit on the basis of tenders thereof and the accounting firm Grant Thornton is the external auditor of the Fund. In the year 2012 a tender was made on the Fund's internal audit for a three year period and based on that tender an agreement has been reached with the audit firm Ernst & Young on the work engagement for the year 2013-2015.

The Board of Directors supervises that all information submitted to supervisory bodies, the Icelandic Financial Supervisory Authority, the Icelandic Central Bank and other authorities is at all time in accordance with law and regulations. The Board of Directors also makes decisions regarding all unusual and substantial matters. In the year 2013, the Board of Directors held 24 Board meetings.

A new Board of Directors was appointed in late September 2013, but since then there have been several changes as to its members. The Directors are:

-Ingibjörg Ólöf Vilhjálmsdóttir, from 24 September 2013
-Haukur Ingibergsson, from 24 September 2013
-Stefán Ólafsson, from 24 September until 3 January 2014
-Hrund Hafsteinsdóttir, from 24 September 2013 until 1 October 2013
-Kristrún Heimisdóttir, 24 September 2013 until 3 December 2013
-Rósa Guðbjartsdóttir, from 24 September until 17 October 2013
-Haukur Fossberg Leósson, from 12 November 2013
-Steinunn Valdís Óskarsdóttir, from 3 December 2013
-Drífa Snædal, from 8 January 2014

Executive Board

The CEO receives orders directly from the Housing Financing Fund´s board and his performance in all matters and in regards to the operations of the Fund is as according to the guidelines of the board and as provided by law. The Director shall make decisions about all the affairs of the Fund that are not entrusted others by legislation, the Fund´s statutes or the Board's decision, but the overseeing of daily operations does not include measures that are unusual or extraordinary. The Director is responsible for personnel matters but the implementation of these matters is the responsibility of the Human Resource Manager and Division Managers. The CEO shall initiate the Fund´s strategic policy and make recommendations thereon to the Board. The CEO attends board meetings and has the right to discuss and make motions and is responsible for implementing the decisions of the Board. Under the Housing Act 44/1998, the Financial Supervisory Authority shall evaluate the competence of the CEO and the Board.

Endorsement and Statement by the Board of Directors contd.

The Executive Board is comprised of senior managers and executive meetings are held weekly to review the affairs of the Fund and to make decisions concerning daily operations. The Executive Board focuses on major decisions and makes recommendations for strategic policy decisions to the Board. The financial and operational budgets are based on policies established and approved by the Board. The Executive Board examines the financial reports, reports on risk management, credit and delinquency trends, the policies of the Fund and other reports related to the operations of the Fund.

Committees and policies

According to law no. 80/2008 the Fund´s Board has established an audit committee to carry out certain assignments which are a part of the Board´s responsibilities. The audit committee shall oversee the process of preparations of the financial statements in order to increase credibility of financial information. One of the members is Vice-president of the Board and another member is a Certified Public Accountant. A compliance officer is employed by the Fund and submits annually a report on the duties of the compliance position.

The Fund´s Financial Committee monitors risk management and liquidity management, and makes recommendations to the Board on issues regarding the Fund´s financing. The members of the Committee are the CEO, the CFO, the director of risk management and a board member. The Committee meets on regular basis but no less than monthly and its minutes are presented to the Board.

The Security Committee meets on a monthly basis to discuss information security. The Committee has twice received verification for ISO27001, a standard adopted by the Fund which was implemented and certified in the year 2012.

Two loan committees authorized by the CEO operate within the Fund, on the one hand for loans to individuals and on the other for loans to legal entities. All decisions regarding the granting of loans to legal entities are administered by the loan committee, other than those pertaining to the Fund´s biggest loans which are also approved by the Board. The granting of loans to individuals is administered by two employees of the home loan division or by the committee. Furthermore decisions that are equivalent to granting loans are in general administered by the committee.

In 2013 the decision was made for the establishment of a payment difficulties committee to oversee all decisions granting payment solutions. The Committee consists of three employees and began operations in early 2014. The purpose of the committee is to coordinate procedures and decision-making regarding the granting of solutions and insure equality among the applicants for payment solutions.

The Fund has established a personnel policy, a policy and plan against bullying and sexual harassment, and an equality plan. The personnel policy is reviewed and assessed on an annual basis. The Fund aims to establish a formal remuneration policy.

The Fund and the Ministry of Welfare interact monthly where all the Fund´s main affairs are discussed. Furthermore, the Minister meets with the Board of Directors and the CEO two times a year where the Fund's standing is presented. The Minister of Welfare has authorised the Board of Directors and the CEO to have firsthand and informed communication with the committee on financial stability, the Ministry of Finance and the Council of Ministers on financial matters due to specific aspects of the operations of the Fund.

Statement by the Board of Directors and the CEO

The financial statements of the Housing Financing Fund for the year 2013 are prepared in accordance with International Financial Reporting Standards as adopted by the EU and additional Icelandic disclosure requirements for financial statements of companies with listed securities.

According to our best knowledge, it is our opinion that the financial statements give a true and fair view of the financial performance of the Fund for the year 2013, its assets, liabilities, and financial position as at 31 December 2013 and changes in cash flows for the year 2013.

Further, in our opinion the financial statements and the Endorsement by the Board of Directors and the CEO include a fair view of the Fund's development and performance and its standing and describes the Fund's main risk exposures.

Endorsement and Statement by the Board of Directors contd.

The Board of Directors and the CEO of the Housing Financing Fund have today discussed the Fund's Financial Statements for the year 2013 and hereby confirm them by means of their signatures.

Reykjavik, 31 March 2014.

Board of Directors:

Ingibjörg Ólöf Vilhjálmsdóttir, chairman of the board

Drífa Snædal

Haukur F. Leósson, vice chairman of the board

Haukur Ingibergsson

Steinunn Valdís Óskarsdóttir

CEO:

Sigurður Erlingsson

Independent Auditors' Report

To the Board of Directors of the Housing Financing Fund,

We have audited the accompanying Financial Statements of the Housing Financing Fund for the year 2013. The Financial Statements comprise the statement of income and comprehensive income, the balance sheet, the changes in equity, cash flow, and a summary of significant accounting policies and other explanatory information.

Management´s Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these Financial Statements in accordance with International Financial Reporting Standards as adopted by the EU. This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of Financial Statements that are free from material misstatements, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

Auditors' Responsibility

Our responsibility is to express an opinion on these Financial Statements based on our audit. We conducted our audit in accordance with International Standards on Auditing. Those standards require that we comply with relevant ethical requirements and plan and perform the audit to obtain reasonable assurance whether the Financial Statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the Financial Statements. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the Financial Statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the Financial Statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control. An audit also includes evaluating the appropriateness of accounting principles used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the Financial Statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the Financial Statements give a true and fair view of the financial position of the Company as of 31 December 2013, of its financial performance and its cash flows for the year then ended in accordance with the law and generally accepted accounting principles of Iceland.

Emphasis of matter

Without qualifying our opinion we draw attention to the Fund´s equity ratio which is calculated on the basis of regulation no. 544/2004 on the financial and risk management of the Housing Financing Fund and is 3.4% at year end 2013, cf. Note 6.f. According to article 7 of the regulation mentioned above the Fund´s long terms goal is to maintain an equity ratio of 5.0%. The Board of Directors in accordance with the provisions of the said Regulations notified the Minister of Social Affairs and Housing thereon.

Furthermore, we draw attention to Notes 3a and 4a which outline compliance with IFRS and its impact if the Fund considered loss impairment in the realization of interest income in the income statement as required by the standard IAS 39.

Finally, we draw attention to the discussion in the Endorsement and Statement by the Board of Directors and CEO, as discussed in Note 25, on the Fund´s ability to continue as a going concern.

Reykjavik, 31 March 2014.
Grant Thornton endurskoðun ehf.

Sturla Jónsson	Davíð Arnar Einarsson
State Authorized Public Accountant	State Authorized Public Accountant

Income Statement and Statement of Comprehensive Income

	Notes	2013	2012
Interest income		69.864.947	77.467.433
Interest expense		(66.917.987)	(74.982.586)
Net interest income	4a,12	2.946.960	2.484.847
Other income		160.893	171.480
Total operating income		3.107.853	2.656.327
Salaries and salary-related expenses	13	908.402	768.946
Other operating expenses	15	1.195.956	1.048.573
Depreciation and amortisation	20	58.957	67.778
Total operating expenses		2.163.315	1.885.297
Revenue in excess of expenses of properties held for sale	16	389.459	178.521
Net operating income		1.333.997	949.551
Impairment	6b, 10	(5.687.980)	(8.805.592)
Loss for the year and comprehensive loss		(4.353.983)	(7.856.041)

The notes on pages 12 to 33 are an integral part of these Financial Statements.

Financial Statements of the Housing Financing Fund for the year 2013 8 Amounts in ISK thousand

Balance Sheet as at 31 December 2013

	Notes	2013	2012
Assets			
Cash and cash equivalents	7	7.916.388	10.766.771
Receivable due from State Treasury	2	4.500.000	13.000.000
Treasury securities	8	32.294.209	27.904.569
Loans to banks	9	11.054.906	13.946.454
Loans	6b	768.480.860	779.095.331
Properties held for sale	16	37.663.230	30.369.116
Investment in subsidiary	17	10.000	0
Operating assets	18	69.505	71.309
Intangible assets	19	151.428	147.721
Claims on related parties	24	73.180	0
Other assets		733.317	762.467
Total assets		862.947.023	876.063.738
Liabilities			
Bond issues	21	834.463.465	849.550.870
Other borrowings	22	4.273.495	4.702.013
Other liabilities		9.364.674	7.111.483
Total liabilities		848.101.634	861.364.366
Equity			
Contributed capital	2	57.655.408	53.155.408
Accumulated deficit		(42.810.019)	(38.456.036)
Total equity		14.845.389	14.699.372
Total liabilities and equity		862.947.023	876.063.738

The notes on pages 12 to 33 are an integral part of these Financial Statements.

Financial Statements of the Housing Financing Fund for the year 2013 9 Amounts in ISK thousand

Statement of Changes in Equity for the year 2013

Year 2012	Contributed **capital**	**Accumulated deficit**	**Equity Total**
Equity as at 1 January 2012	40.155.408	(30.599.995)	9.555.413
Increase in contributed capital	13.000.000		13.000.000
Loss for the year and comprehensive loss		(7.856.041)	(7.856.041)
Equity as at 31 December 2012	53.155.408	(38.456.036)	14.699.372

Year 2013			
Equity as at 1 January 2013	53.155.408	(38.456.036)	14.699.372
Increase in contributed capital	4.500.000		4.500.000
Loss for the year and comprehensive loss		(4.353.983)	(4.353.983)
Equity as at 31 December 2013	57.655.408	(42.810.019)	14.845.389

The notes on pages 12 to 33 are an integral part of these Financial Statements.

Amounts in ISK thousand

Statement of Cash Flows for the year 2013

	2013	2012
Cash flows from operating activities		
Loss of the year and comprehensive loss	(4.353.983)	(7.856.041)
Adjusted for:		
Indexation on loans to banks and loans to customers	(29.725.948)	(37.343.963)
Indexation on borrowings	30.982.990	38.646.017
Depreciation and amorisation	58.957	67.778
Impairment	5.687.980	8.805.592
Changes in operating assets and liabilities:		
Loans	32.943.599	29.466.215
Properties held for sale	(6.341.763)	(7.882.432)
Other assets	(51.073)	877.409
Other liabilities	2.253.193	3.499.213
Cash flows from (to) operating activities	31.453.952	28.279.788
Cash flows from investing activities		
Claims on related parties	(73.180)	0
Investment in subsidiaries	(10.000)	0
Loans to (from) banks	2.627.610	1.060.770
Treasury securities	9.711.009	6.979.377
Restricted cash	0	9.112.767
Investment in operating assets and intangible assets	(60.860)	(67.749)
Cash flows from (to) investing activities	12.194.579	17.085.165
Cash flows from financing activities		
Bond issues and other borrowings, issues	0	5.779.434
Bond issues and other borrowings, repayments	(46.498.913)	(44.340.172)
Cash flows to financing activities	(46.498.913)	(38.560.738)
Net increase (decrease) in cash and cash equivalents	(2.850.382)	6.804.215
Cash and cash equivalents at the beginning of the year	10.766.771	3.962.556
Cash and cash equivalents at year end	7.916.388	10.766.771
Investing and financing activities without cash flow effect		
Receivable from State Treasury due to increase in capital 2012 ..	(13.000.000)	13.000.000
Increase in contributed capital	0	(13.000.000)
State Treasury receivable delivered	13.000.000	0
Receivable from State Treasury due to increase in capital 2013 ..	(4.500.000)	0
Increase in contributed capital	4.500.000	0

The notes on pages 12 to 33 are an integral part of these Financial Statements.

Amounts in ISK thousand

Notes

General information

1. Reporting entity

The Housing Financing Fund ("the Fund") is domiciled in Iceland. The address of the Fund's registered office is Borgartún 21, Reykjavik. The Fund's objectives are to provide housing loans, loans for new constructions and property renovations in Iceland. The Housing Financing Fund is an independent institution owned by the State. The Fund operates in accordance with the Housing Act no. 44/1998 and appertains to a special management and the Minister of Welfare. The Housing Financing Fund is subject to supervision of the Financial Supervisory in Iceland in accordance with Act. 87/1998 on Official Supervision of Financial Activities. According to the law, the Icelandic State Treasury guaranties all of the Fund's financial obligations.

2. Increase in contributed capital

In accordance with the approval of Parliament on the supplementary budget for the year 2013, the Minister of Finance and Economic Affairs received authorization to increase the Fund's contributed capital by a contribution amounting to ISK 4,500 million, in order to enhance the equity position of the Fund. The commitment was recognised as an asset in the balance sheet with a corresponding increase in equity at year-end 2013. The contribution will be paid/deposited in early 2014 by means of government bonds which carry interest from 1 January 2014.

3. Basis of preparation

a. *Statement of compliance*

The Financial Statements have been prepared in accordance with the International Financial Reporting Standards (IFRS) as adopted by the EU, except for the departure from the accounting standard IAS 39, Financial Instruments: Recognition and Measurement, specifically article 63 in respect of the realization of interest income on impaired loans, cf. note 4.a. According to the standard, consideration should be given to the impairment of loans in the calculation of interest income (net), however in the Fund´s income statement interest income is calculated without accounting for the impairment of loans (gross). The opinion of the Fund´s directors is that the presentation of gross interest income gives a truer and fairer view of net interest income given the purpose of its operations and risk management, and furthermore this methodology is in accordance with the Fund´s prior operational plans and financial information. Managers decide on interest rates on the basis of a premium on the cost of capital and not on the underlying risks as by regions. The margin on interest is based on issued bonds and managers assess the margin in its decision making as that is in accordance with risk management and approved plans. The departure from the requirements of IAS 39.63 does not affect the performance of the Fund or its equity, cf. note 4a.

The Financial Statements of the Housing Financing Fund were approved by the Board of Directors on 31 March 2014.

b. *Basis of measurement*

The Financial Statements have been prepared on the historical cost basis except for trading securities that are measured at fair value and properties held for sale are recognised at the lower of cost or net fair value.

c. *Changes in presentation*

The Fund changed the presentation of income and expenses of properties held for sale. Income from properties held for sale was previously recorded as other operating income and costs of properties held for sale were previously recorded as other operating expenses. Income and expenses of properties held for sale are now presented as revenues in excess of expenses of properties held for sale in the Income Statement, as according to note 16. Comparative figures have been adjusted accordingly.

d. *Functional currency*

The Financial Statements are prepared and presented in Icelandic krona (ISK), which is the Fund's functional currency. All financial amounts presented have been rounded to the nearest thousand unless otherwise stated.

e. *Uses of estimates and judgements*

The preparation of financial statements in conformity with the IFRS requires management to make judgements, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses. The estimates and underlying assumptions are based on historical experience and various other factors that are believed to be reasonable at the reporting date, the results of which form the basis of making the judgements about carrying amounts of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates.

Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised and the effect of the changes are entered in the periods that the changes are made and in subsequent periods if the change also affects those periods.

3. Basis of preparation, contd.

e. Uses of estimates and judgements,contd.

Information about significant areas of estimation uncertainty that have the most significant effect on the amounts recognised in the financial statements are described in the following notes:

- Impairment on loans, see note 6b.
- Receivables and payables to fallen credit institutions, see note 10.
- Properties held for sale, see note 16.

f. New standards and interpretations not yet adopted

The Fund has adopted all International Financial Reporting Standards and interpretations applicable to the Fund's operation and which have been adopted by the EU and have entered into force at year end 2013. The Fund has however not adopted standards and interpretations adopted by the EU but which will enter into force after year end 2013. These standards and interpretations are not assumed to have significant effect on the Fund's financial statements.

These standards and interpretations should not have a material impact on the Fund´s Financial Statements when they become effective.

IFRS 13 Fair Value Measurement became effective in the beginning of the year 2013. The standard provides a framework for fair value measurement and disclosures of fair value when such a measurement is required or permitted by IFRS. The standard defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Notes provisions have also been expanded. Implementation of the standard did not have an impact on the fair value measurement of the Fund´s assets or liabilities.

4. Significant accounting policies

The accounting policies set out below have been consistently applied to all periods presented in these financial statements. No revenues or expenses of the Fund are recognised directly in other comprehensive income and the result for the year is therefore equal to comprehensive (loss) income.

a. Interest income and interest expense

Interest income and expense are recognised in the income statement using the effective interest method and consist of interest income on loans to customers, cash and cash equivalents, restricted cash, treasury securities and loans to banks, and interest expenses on borrowings. Interest income and expense includes the amortisation of discounts and premiums and other differences between initial book value of the financial instrument and amounts due on maturity, based on the effective interest method. Borrowing fee arising from loans granted as well as the Fund´s financing is recognised in the income statement in the same manner as interest income and expense and those items are taken into account in the calculation of effective interests.

Effective interest is the imputed rate of interest used in determining the present value of estimated cash flow over the estimated useful life of a financial instrument or a shorter period if applicable, so that it equals the book value of the financial asset or liability in the balance sheet. When calculating the effective interest rate the Fund estimates future cash flows considering all contractual terms of the instrument but not future credit losses.

Indexation of inflation-indexed assets and liabilities are recognised in the income statement among interest income and expenses as they accrue and in the balance sheet as part of the carrying amount of assets and liabilities.

As discussed in note 3, management has departed from the requirements of IAS 39 regarding the realization of interest income using the effective interest rate as interest income is calculated without considering the impairment of loans. The following table shows the effect of the departure on the presentation of the income statement if the requirements of the standard of IAS 39.62 were upheld and interest income was realized on the book value of loans, adjusted for impairment.

Notes, contd.:

4. **Significant accounting policies ,contd.**

a. *Interest income and interest expense, contd.*

	Acc. IAS 39.63		Acc. Financial statements		Effect	
	2013	**2012**	**2013**	**2012**	**2013**	**2012**
Interest income...........	68.094.590	75.620.007	69.864.947	77.467.433	(1.770.357)	(1.847.426)
Interest expense..........	(66.917.987)	(74.982.586)	(66.917.987)	(74.982.586)	0	0
Net interest income.......................	**1.176.603**	**637.421**	**2.946.960**	**2.484.847**	**(1.770.357)**	**(1.847.426)**
Other income..............	160.893	171.480	160.893	171.480	0	0
Operating expenses.....................	(2.163.315)	(1.885.297)	(2.163.315)	(1.885.297)	0	0
Net operating income of properties held for sale	389.459	178.521	389.459	178.521	0	0
Net operating income.......................	**(436.361)**	**(897.875)**	**1.333.997**	**949.551**	**(1.770.357)**	**(1.847.426)**
Impairment	(3.917.623)	(6.958.166)	(5.687.980)	(8.805.592)	1.770.357	1.847.426
Loss...........................	**(4.353.983)**	**(7.856.041)**	**(4.353.983)**	**(7.856.041)**	**0**	**0**

The Fund has provided loans for rental apartments at a 3.5% and 4.5% interest rate. The State Treasury compensates the Fund the interest difference between those loans and loans taken by the Fund. The State Treasury's contribution is based on the difference between borrowing and lending rates each year (see note no. 12). The aforementioned loans to rental apartments are inflation-indexed on floating interests. No long term agreement has been made between the Fund and the State on subsidy of interests on these loans but the subsidy is determined on annual basis by the State and approved in the national budget. If the State's subsidy for the payment of the interests would no longer be granted interests on the loans should be increased in order to secure the Fund's financial return and interest margin There are loan issues in the amount of approximately ISK 8,000 million granted in the years 2001-2009 for social benefits where State compensations do not apply.

b. *Other income*

Other income consists of collection charges. Other income is recognised in the income statement when accrued. Borrowing fees are included in the calculation of effective interest rate. They are included in interest income and not other income.

c. *Other operating expenses*

Other operating expenses consist of housing costs, operation of IT systems, collection expenses, purchased expert services, contribution to the operation of the Debtors' Ombudsman and other general operating expenses, cf. note 15. Operating expenses are recognised as they are incurred.

d. *Net operating income of properties held for sale*

Net operating income of properties held for sale consist of rental income and expenses of properties held for sale, cf. note 16.

e. *Subsidiaries*

Subsidiaries are entities controlled by the Company. Control exists when the Company has the power, directly or indirectly, to govern the financial and operating policies of an entity so as to obtain benefits from its activities. In assessing control, potential voting rights that presently are exercisable or convertible are not taken into account. The operations of the Fund´s subsidiary are immaterial during the year and therefore the Fund´s financial statements are not prepared on a consolidated basis.

f. *Financial assets and liabilities*

(i) Recognition and derecognition of financial assets and liabilities

Purchase and sale of financial assets is recognised at the date of transaction. Those assets and liabilities are recognised on the date on which the Fund commits to purchasing or selling the asset, except for loans that are recognised when funds are transferred to borrowers. Financial assets are derecognised when the contractual rights to the cash flows from the asset expire, or when the Fund transfers the rights to receive the cash flows on the financial asset in a transaction in which substantially all the risks and rewards of ownership of the financial assets are transferred.

Financial liabilities are recognised when the Fund becomes a party to the contractual provisions of the instrument. The Fund derecognises a financial liability when its contractual obligations are discharged or cancelled or expire.

Amounts in ISK thousand

4. Significant accounting policies, contd.:

f. Financial assets and liabilities, contd.

(i) Recognition and derecognition of financial assets and liabilities

To ensure efficient price determination of its issued bonds the Fund has entered into agreements with market makers on a short term securities loans, where the Fund lends to the market maker its own bonds against collateral security for a maximum of 28 days. The bonds lent are not recognised in the balance sheet. The collaterals are not capitalised in the balance sheet as the risks and rewards remain with the Fund's counterparty. At the end of the agreement term, the Fund receives the bonds lent and returns the collaterals to the market maker.

(ii) Offsetting

Financial assets and liabilities are set off and the net amount is recognised in the balance sheet when, and only when, the Fund has the legal right to set off the amounts and intends either to settle on a net basis or realise the asset and settle the liability simultaneously.

(iii) Amortised cost of financial assets and liabilities

The amortised cost of a financial asset or liability is the amount at which the financial asset or liability is measured upon initial recognition, minus principal repayments, taking into account the cumulative amortisation of premiums and discounts using the effective interest method. Discounts and premium constitute the difference between the initial book value of the financial instrument on the one hand, and its nominal value on the other. In calculating the amortised cost of financial assets impairment is also taken into account, if any.

(iv) Fair value measurement

Fair value is the price received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

The best measurement of the fair value of financial instruments is based on the quoted price in an active market and is used when readily available. For other financial instruments fair value is determined by using valuation techniques. A financial asset or liability is considered to be listed on an active market if the official price can be obtained from a stock exchange or another independent party and the price reflects actual and regular market transactions between unrelated parties.

(v) Impairment of financial assets

The carrying amount of the Fund's financial assets is reviewed at each reporting date to determine whether there is any indication of impairment. If any such indication exists, the asset's recoverable amount is estimated.

An impairment is recognised in the income statement whenever the carrying amount of an asset exceeds its recoverable amount. An impairment loss is expensed in the income statement.

Two methods are used to calculate impairment losses on loans; one based on assessment of individual loans and the other based on collective assessment. Estimated loss as a result of future events, irrespective of the probability thereof, is not recognised.

Objective evidence of impairment includes information on the following events and conditions:

(i) significant financial difficulty of the borrower,
(ii) deteriorating economic conditions,
(iii) a breach of contract, such as a default on instalments or on interest or principal payments.

Individually assessed loans

Impairment losses on individually assessed loans are determined by the risk exposure on a case-by-case basis. The Fund assesses at each reporting date whether there is any objective evidence that individual loans are impaired.

Impairment losses are measured as the difference between the carrying amount of the financial assets and the present value of estimated future cash flows discounted with the assets' original effective interest rate. Impairment losses are recognised in profit or loss and reflected in an allowance account as deduction in their carrying amount.

4. Significant accounting policies, contd.:

f. *Financial assets and financial liabilities, contd.:*

(v) Impairment of financial assets

Collectively assessed loans

Where loans have been individually assessed and no evidence of loss has been identified, these loans are grouped in loan portfolios on the basis of similar credit risk characteristics for the purpose of calculating a collective impairment loss.

The collective impairment loss is determined by taking into account:

- historical loss experience in portfolios of similar risk characteristics,
- the estimated period from when a loss has occurred and until that loss is identified and recognised by contribution to an allowance account
- management's experienced judgement as to whether the current economic and credit conditions are such that the actual level of inherent losses is likely to be greater or less than that suggested by historical experience.

Changes in impairment on loan portfolios are consistent with changes in observable data from period to period, for example changes in property prices, payment status, or other factors indicative of changes in the probability of losses on the group and their magnitude. The methodology and assumptions used for estimating impairment are reviewed regularly by the Fund to minimise any differences between loss estimates and actual losses.

Reversal of impairment

If, in a later period, the amount of an impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised, the previously recognised impairment loss is reversed in the income statement.

g. *Cash and cash equivalents*

Cash and cash equivalents consist of demand deposits with financial institutions.

h. *Treasury securities and loans to banks*

Treasury bonds and loans to banks consist of government treasury bonds, interbank loans and unsettled claims on the Icelandic banks and other financial institutions connected to the Icelandic financial crisis (see note 11). Treasury bonds are divided into securities listed on an active market and securities (RIKS30 and RIKS33) listed on the stock exchange but without an active market, which are capitalised based on amortised cost and initial rate of return.

i. *Loans*

Loans are financial instruments with fixed or determinable payments that are not quoted in an active market. Loans and receivables include loans granted by the Fund to its customers and acquired loans, which are unlisted and will not be sold in the nearest future.

The loans are initially measured at fair value which represents the loan amount plus all direct transaction costs. The loans are then measured at their amortised cost using the effective interest method. The book value of loans and receivables includes accrued interest and inflation adjustments.

j. *Properties held for sale*

When the Fund redeems properties on foreclosed mortgages they are recognised as properties held for sale in the balance sheet. Redeemed properties are recognised at the lower of cost or net fair value. The fair value is determined as the market value of the property. The fair value is measured on the basis of a realtor's evaluation, if available, or price information from a list for real transactions with similar properties. In some cases evaluations of the asset management division of the Fund are used.

If the net fair value of a property held for sale decreases after its initial recognition the fair value decrease is expensed as impairment loss (see note 6b). If the net fair value increases in the future the previously recognised impairment loss is reversed but only to the extent that the carrying amount does not exceed the initial cost value. The reversal is recognised as a reduction to the previously charged impairment.

4. Significant accounting policies, contd.:

k. *Operating assets*

Operating assets are recognised at cost less accumulated depreciation.

Depreciation

Depreciation is recognised in the income statement on a straight-line basis over the estimated useful lives of operating assets.

Estimated useful life is specified as follows:

Real estate	25 years
Fixtures and equipment	5-10 years

Residual value is reviewed annually unless it is immaterial.

l. *Intangible assets*

Intangible assets consist of software used in the Fund's operations. Intangible assets are amortised on a straight-line basis over the estimated useful life, which is 3 - 5 years.

m. *Issued bonds and other borrowings*

Issued bonds and other borrowings are initially recognised at fair value, which is the loan amount in addition to all costs associated with the transaction. After initial recognition they are measured at amortised cost using the effective interest rate method. Accrued interest expense and indexation are recognised as a part of the carrying amount.

n. *Equity*

The Fund's equity consists of contributed capital on the one hand and accumulated deficit on the other. The accumulated income or loss of the Fund from its establishment is recognised in accumulated deficit.

5. *Segment information*

A segment is a component of an entity that generates income and expenses that are directly attributable to the segment. Management assesses and evaluates the performance and financial results of the segment and distributes funds specifically to the segment. Financial information of the segment must be separable for operational purposes in order to be identified as a segment. Financial information of the segment must be separable fo operational purposes in order to be identified as a segment. The Fund identifies its operations as a single segment.

6. Risk management

a. *Overview of financial risks and the risk management structure*

A key issue in the Fund's daily management is to reduce its risk exposure related to financial assets and liabilities. Following are the risks that the Fund is exposed to and which are of importance:

- Credit risk
- Liquidity risk
- Interest rate risk, prepayment risk and indexation risk
- Operational risk

The following include information on the Fund's financial risk management, in addition to information on each of the aforementioned risks, goals, aim and evaluation process along with management of each risk. Furthermore, information on the Fund's capital management is disclosed.

Risk management structure

The Housing Financing Fund is a non-profit organisation. Its financial and risk management takes note thereof. Its main objective is to continuously seek to keep low risk level in its financial operation. Furthermore, the Fund aims at limiting financial risk and cost in accordance with its operating goals.

The Fund appoints a Financial Committee consisting of the CEO, Financial Director and a finance expert. The Committee's role is to ensure sufficient disclosure of information to the Board and that finance experts in the finance department follow the financial and risk management policies. Rules on financial and risk management shall be reviewed on a regular basis, in line with changes in the financial environment and changes in the operation of the Fund.

6. Risk management, contd.:

a. *Overview of financial risks and the risk management structure, contd.:*

The Fund's Board of Directors

- Establishes the Fund's financial and risk management policy and reviews on a regular basis reports on the Fund's financial risk.
- Takes note of risk factors in the Fund's administration and organisation.
- Appoints a financial committee.
- Submits reports to the Minister of Welfare.

CEO

- Reviews reports on the Fund's risks.
- Responsible for the Fund's long term financing need being met.
- Divides responsibility of financial matters in accordance with the financial and risk management policy between the financial committee and the financial department.

Financial Risk Committee

- Brings proposals before the Board of Directors on new bond issuance.
- Brings proposals before the Board of Directors on interest levy on loan interests in accordance with the Fund's rules.

Head of financial department

- Responsible for the implementation of risk management and risk analysis and ensures that all of the Fund's payments and financial agreements are within its financial and risk management policy.
- Directs the Fund's financial and risk management departments.
- Works on proposals on revision of the financial and risk management policy.

Risk management

- Takes care of daily risk management operation.
- Shares knowledge and risk awareness within the Fund.

Treasury

- Takes care of the Fund's financing and financial operations and ensures a safe and efficient handling of securities.

Hedges

It is important to maintain a certain balance in the Fund's combination of borrowings and loans. The Fund's financial and risk management rules stipulate that the Fund must limit its risks and manage interest rate and credit risk within a certain threshold.

The Fund's financial and risk management operates in accordance with the Fund's financial and risk management rules. The rules define the risks and their margin of tolerance in the Fund's operation.

b. *Credit risk*

Credit risk is the risk of financial loss if a customer or a counterparty to a financial instrument fails to meet its contractual obligations. The Fund's credit risk arises from loans to customers, investments in market securities and loans to banks. As stated before it is the Fund’s main objective to maintain low risk level in its operations.

Solutions for the payment difficulties of the Fund’s clients

In addition to general payment difficulty solutions, i.e. rescheduling of amounts in default and deferral of repayments due to temporary payment difficulties, the Housing Financing Fund participates in the payment difficulty solutions established on the one hand by the State and on the other hand, by joint effort of lenders in the housing market.

Solutions for the payment difficulties of the Fund’s clients

General solutions for payment difficulties, i.e. rescheduling of amount in default, deferral of repayments and term extensions, are mainly intended to meet temporary payment difficulties. These solutions are often used all together, i.e. amounts in default are rescheduled (changed to a new loan, a so-called reschedule loan), payment is suspended (interest suspension) and finally, the maturity of loans is extended by a period corresponding to at least the suspension period.

Specific solutions for payment difficulties, specific debt and payment adjustments for individuals have been established to meet payment difficulties of individuals.

6. Risk management, contd.:

b. Credit risk, contd.

Specific debt adjustment is based on an agreement between lenders on the housing loan market and is intended for those who have the ability to pay on their mortgage claims corresponding to the value of the property. A debtor pays on the claims, or contractual claims, for 3 years. If the debtor honors the agreement, claims in excess of the property value and contractual claims not paid during the period will be cancelled or written off. Time limit to apply for the specific debt adjustment expired at year-end 2012.

The Fund has also entered into agreements with customers to avoid the enforcement process, which includes restructuring and payment distribution of arrears for up to 18 months. A total of 455 homes had active contracts with the Fund for the payment of arrears for up to 18 months at the end of 2013.

Payment adjustments are intended to allow individuals with serious payment difficulties to reorganise their finances and establish balance between their debt and ability to pay so that they will have a realistic possibility to meet their obligations in the foreseeable future. The term of a debt adjustment lasts for 1-3 years during which the debtor pays on the claims corresponding to the value of the property. The debtor can then apply for a write-off of mortgage claims in excess of the market value of the property at the end of the period provided that legal conditions are met.

These solutions decrease considerably the cash payments towards the Fund. In addition, for specific debt and payment adjustments for individuals it is always assumed that claims in excess of the market value of properties will be written-off, should the applicant fulfil the contract.

Lifting of mortgage claims in excess of the sale price was established in order to facilitate sale of over-mortgaged properties where the owners are unable to pay on the loans in the future and can sell the property on a general market. Lifting of mortgage claims in excess of sale price is also applied on the basis of the Act on payment adjustment.

Households with unpaid mortgage claim in excess of 110% of the value of the properties were offered the option of writing down the loan to 110%. The time limit to apply for this solution expired on 1 July 2011.

Payment Detainment is a solution available to temporarily relieve the payment burden of loans by linking the loans to a so called Payment Detainment Index instead of the CPI. Approximately 50.6% of the value of the loans to individuals utilized this option at the end of the year 2013 (2012:51.3%).

Information on possible solutions for payment difficulties can be found on the Fund's website. The following table shows the extent of these solutions based on the prepayment value of loans in the relevant solution category.

	2013	2012
Payment suspension......	4.944.343	8.263.053
Rescheduled loans......	2.289.755	2.293.091
Extending the maturity of loans......	8.672.691	8.558.228
Specific solutions......		
- Specific debt adjustments	10.262.905	5.810.839
- Payment adjustments	9.583.006	6.047.752
- Lifting of mortgage claims in excess of sale price- outstanding amount of loans	4.597.556	2.354.493

Lifting of claims in excess of sale price is applied when the Fund´s claims are greater than the valuation of an asset sale or its forced sale.

Outstanding amount of loans with write-off in excess of 110% of the value of the property......	54.741.901	56.765.188

More than one solution in the table here above may have been applied to the same loan. Comparative figures for loans in payment suspension have been changed as they were incorrect in the Financial Statements in the year 2012.

Credit risk management

All of the Fund´s loans to customers are secured by real estate mortgages. The Fund limits its risk due to these loans in two ways: by setting a maximum individual loan amount and a maximum pledge ratio. In addition, borrowers need to undergo a credit evaluation. The finance committee evaluates the Fund's credit risk on an ongoing basis and determines the price thereof as part of the spread on the Fund's borrowing rates on loans when lending interest rates are determined.

Financial Statements of the Housing Financing Fund for the year 2013 19 Amounts in ISK thousand

6. Risk management, contd.:

b. *Credit risk, cont.:*

Credit risk management, contd.:

As insurance for securities loaned to market makers with the Fund's bonds, the Fund holds pledge in the form of cash or securities. Pledgeable securities are issued securities with market makers, issued by the Government Debt Management and also the Fund's own bonds. The Fund's pledge is invariably well over 100% in these transactions.

Credit risk exposure

The following table shows an age analysis of total default on loans.

	Loans to individuals		Loans to legal entities		Total	
	2013	**2012**	**2013**	**2012**	**2013**	**2012**
Loans past due:						
31-60 days..............	467.095	527.899	214.321	210.089	681.416	737.988
61-90 days..............	336.555	407.243	98.704	99.577	435.259	506.820
Past due over 90 days	4.293.635	5.023.724	4.546.940	2.598.823	8.840.575	7.622.547
Total past due.........	5.097.285	5.958.866	4.859.965	2.908.489	9.957.250	8.867.355

The following table shows the carrying amount of loans that are neither past due nor impaired, the carrying amount of loans that are past due and not impaired and the carrying amount of loans that are impaired.

	Loans to individuals		Loans to legal entities		Total	
	2013	**2012**	**2013**	**2012**	**2013**	**2012**
Neither past due nor impaired						
Total.......................	541.066.469	543.112.404	80.556.629	77.399.506	621.623.098	620.511.910
General impairment.............	(533.317)	(583.183)	(82.275)	(75.842)	(615.592)	(659.025)
Carrying amount.....	540.533.153	542.529.221	80.474.354	77.323.664	621.007.507	619.852.885
Past due and not impaired						
31-60 days..............	16.211.140	17.388.603	144.671	287.218	16.355.811	17.675.822
61-90 days..............	11.581.469	7.779.659	145.336	304.519	11.726.805	8.084.178
Past due over						0
90 days..................	19.907.389	30.588.179	1.698.531	1.269.567	21.605.920	31.857.746
General impairment.............	(361.642)	(355.152)	(21.029)	(17.007)	(382.671)	(372.159)
Carrying amount.....	47.338.355	55.401.289	1.967.510	1.844.298	49.305.865	57.245.587
Impaired						
Total........................	58.471.402	63.548.459	61.136.296	60.729.072	119.607.698	124.277.531
Specific................... impairment	(8.941.937)	(9.064.584)	(12.498.273)	(13.216.088)	(21.440.210)	(22.280.672)
Carrying amount.....	49.529.465	54.483.875	48.638.023	47.512.984	98.167.488	101.996.859
Loans total............	637.400.973	652.414.385	131.079.887	126.680.946	768.480.860	779.095.331
Impairment as proportion of loans..................	1,52%	1,51%	8,77%	9,51%	2,84%	2,91%

Obligations not recognised in the balance sheet:	**2013**	**2012**
Binding loan commitments at year-end..	2.093.000	7.391.600

Financial Statements of the Housing Financing Fund for the year 2013 20 Amounts in ISK thousand

6. Risk management, contd.:

b. Credit risk, cont.:

Credit risk exposure, contd.:

The Fund regularly reviews its loan portfolios to assess impairment. Prior to determining whether an impairment loss should be recognised in the income statement, the Fund makes judgements as to whether there is any objective evidence indicating that there is a measurable decrease in the estimated future cash flows from individual loans or from a portfolio of loans before the decrease can be identified with an individual loan in that portfolio. This evidence may include observable data indicating that there have been changes in the payment status of borrowers in a group or economic conditions. Management uses estimates based on historical loss experience for assets with similar credit risk characteristics and objective evidence of impairment similar to those in the portfolio when scheduling its future cash flows. The methodology and assumptions used for estimating both the amount and timing of future cash flows are reviewed regularly to reduce any differences between loss estimates and actual loss experience.

A specific provision for impairment of loans to legal entities has been calculated on the basis of the professional judgement of employees and management of the Fund and recognised in the financial statements. The specific provision is based on official information, solvency of the legal entity, condition of underlying assets, information on the standing of the debtors, marketability of the assets and value of pledges.

The experts of the Fund have estimated the need for a provision on loans to individuals. In making this estimate the balance of loans in default and the value of collaterals for the loans was taken into account. Specific provision for impairment due to this has been recognised in the financial statements of the Fund.

The value of pledges is based on the current real estate value at each given time.

General impairment is also recognized in the income statement. See in addition note 4f regarding the estimation of general provisions required for impairment.

Write-off on loans

Loans are written off under the following two circumstances:

- Upon loss on the sale of apartments auctioned, when the sales value is lower than the valuation of the apartment, according to Article 57 of Act no. 90/1991 on forced sale
- Upon the approval of the Housing Financing Fund of the discontinuance of a claim of "lost pledge" in accordance with Regulation no. 359/2010, on the treatment of the Housing Financing Fund's claims for which pledges have been lost

Impairment on loans is specified as follows:

	Individuals		Legal entities		
	Specific impairment	**General impairment**	**Specific impairment**	**General impairment**	**Total 2013**
Year 2013					
Balance at the beginning of the year............	9.064.583	938.335	13.216.088	92.850	23.311.855
Impairment loss (reversal of impairment loss).....................	4.833.825	(43.376)	1.165.204	10.455	5.966.107
Write-off...	(4.956.471)	0	(1.883.018)	0	(6.839.490)
Balance at year end.......................	8.941.937	894.959	12.498.273	103.304	22.438.473

	Individuals		Legal entities		
	Specific impairment	**General impairment**	**Specific impairment**	**General impairment**	**Total 2012**
Year 2012					
Balance at the beginning of the year............	5.860.102	1.411.940	14.530.379	0	21.802.421
Impairment loss (reversal of impairment loss).....................	6.723.919	(473.605)	1.270.630	92.849	7.613.793
Write-off...	(3.519.438)	0	(2.584.921)	0	(6.104.359)
Balance at year end.......................	9.064.583	938.335	13.216.088	92.849	23.311.855

Financial Statements of the Housing Financing Fund for the year 2013 21 Amounts in ISK thousand

6. Risk management, contd.:

b. Credit risk, cont.:

Write-off on loans, contd.:

Total impairment recognised in the income statement is specified as follows:

	2013	2012
Specific impairment loss of loans (reversal of impairment loss)	5.999.029	7.994.549
General impairment on loans	(32.921)	(380.756)
Impairment loss of loans (reversal of impairment loss)	5.966.108	7.613.793
Impairment on properties held for sale	(952.351)	1.545.562
Impairment on other receivables	80.223	64.002
Impairment on loans to banks (see note 9)	594.000	(417.765)
Total expensed impairment	5.687.980	8.805.592

Quality of pledges

The Housing Financing Fund's loans are secured by pledges in real estates. Loans are granted to the maximum of 80% of the purchase price, provided that there are no other restrictions of a maximum loan amount, which is ISK 20 million for individuals. Following the granting of a loan, pledges are not assessed specifically in terms of fair value unless in relation to the evaluation of possible impairment losses. Requirements for general housing loans are that a binding purchase offer has been made, which in general may be equal to the fair value of the specific real estate on the date of purchase.

The weighted average pledging ratio of the Fund's total loans on the official property value is approx. 57.6% at year end 2013 compared to 59.0% at year end 2012. The majority of the Fund's loans have first pledge right. The pledging ratios, i.e. calculated remaining balance on loans without specific impairment as proportion of the official property value, are specified as follows at year end:

	2013	2012
Proportion of the total loans under 50% of the official property value	64,1%	63,7%
Proportion of the total loans from 51 - 70% of the official property value	15,5%	15,6%
Proportion of the total loans from 71 - 90% of the official property value	10,3%	10,4%
Proportion of the total loans from 91 - 100% of the official property value	3,3%	3,4%
Proportion of the total loans from 101 - 110% of the official property value	2,3%	2,4%
Proportion of the total loans over 110% of the official property value	4,5%	4,5%
	100%	100%

Counterparty risk related to securities transactions

The Fund's own bonds, which it has lent to market makers, and underlying pledges are specified as follows at year end:

	2013	2012
Loaned own bonds, market value	2.955.035	3.236.626
Market value of pledges provided by counterparties	3.195.048	3.811.201

c. Liquidity risk

Liquid risk management

Liquidity risk is the Fund's risk of not being able to meet its contractual interest and principal payments on its borrowings. By effective control on liquidity balance the Fund endeavours to ensure that there are always sufficient funds in order to meet its obligations if a temporary imbalance arises between the payment flow on the Fund's loans and other financial assets on the one hand, and its borrowing on the other.

The Fund's liquidity risk management includes liquidity analysis, access to secured loan lines from banks and liquidity plan. The Fund's liquidity plan is determined one year a head in terms of operating and financial budget. The liquidity plan is updated on a regular basis. A short-term plan is concluded daily for liquidity, including the estimation of the Fund's cash flow for the next 20 working days.

Financial Statements of the Housing Financing Fund for the year 2013 22 Amounts in ISK thousand

6. Risk management, contd.:

c. *Liquidity risk, contd.:*

Measurement of liquidity risk

A key issue in the Fund's liquidity management is to ensure that there is balance between payment flow on financial assets and financial liabilities. The following table shows the contractual payment flow of the Fund's financial assets and liabilities.

Remaining balance of financial assets and liabilities:

	0 - 3 months	3 - 12 months	1 - 5 years	Over 5 years	Total
31 December 2013					
Financial					
Cash and cash equivalents............	7.916.388				7.916.388
Receivable due from State Treasury......................	4.500.000				4.500.000
Treasury securities........................	11.155.199	21.139.010			32.294.209
Loans to customers and banks....................................	22.762.871	41.615.301	211.647.521	1.201.913.127	1.477.938.819
Total financial assets.....................	46.334.458	62.754.311	211.647.521	1.201.913.127	1.522.649.416
Financial liabilities:					
Borrowings and other liabilities................................	19.907.418	60.015.060	260.793.114	980.916.257	1.321.631.849
Binding loan commitment..............	523.250	1.569.750	0	0	2.093.000
Total financial liabilities..................	20.430.668	61.584.810	260.793.114	980.916.257	1.323.724.849
Net balance...................................	25.903.790	1.169.501	(49.145.593)	220.996.870	198.924.567
31 December 2012					
Financial					
Cash and cash equivalents............	10.766.771				10.766.771
Receivable due from State Treasury.......................	13.000.000				13.000.000
Treasury securities........................	12.124.652	16.597.552			28.722.204
Loans to customers and banks....................................	24.378.934	41.115.988	225.759.312	1.251.807.498	1.543.061.732
Total financial assets.....................	60.270.357	57.713.540	225.759.312	1.251.807.498	1.595.550.707
Financial liabilities:					
Borrowings and other liabilities................................	19.958.589	57.384.979	275.226.233	1.036.832.213	1.389.402.014
Binding loan commitment..............	671.600	5.010.000	1.710.000		7.391.600
Total financial liabilities..................	20.630.189	62.394.979	276.936.233	1.036.832.213	1.396.793.614
Net balance...................................	39.640.168	(4.681.439)	(51.176.921)	214.975.285	198.757.093

The table above shows contractual cash flow of loans and borrowings of the Fund, including both payments and contractual interests but not estimated future inflation. Cash and cash equivalents of the Fund, which can be used to meet temporary imbalance in cash flows of financial assets and liabilities, is stated in the first column of the table. If an imbalance would occur between the cash flows of financial assets and liabilities, the Fund would response by issuing HFF bonds or selling short term securities.

Financial Statements of the Housing Financing Fund for the year 2013 23 Amounts in ISK thousand

6. Risk management, contd.:

d. *Interest risk*

Interest rate risk is defined as the risk of fluctuation in fair value or future cash flow due to changes in market interests. The Fund recognises neither financial liabilities nor financial assets at fair value, except for treasury bonds which are listed on an active market (see note 8) and fair value risk due to interest rate changes is therefore limited. Around 90.9% of the Fund's financial assets (2012: 90.0%) and 99.1% (2012: 99.7%) of its financial liabilities have fixed interest rates and therefore the effect of interest changes is insubstantial. Decisions on changing interests on loans with floating interests is entirely in the hand of the Fund. However, the difference between the duration of assets and liabilities causes risk exposure for the Fund as interest rate changes can affect its net interest income. The Fund's financial division manages this risk and shall ensure that the difference is within limits established by the Fund's financial and risk managements policy. The duration of the Fund's financial assets at year end 2013 is 9.7 years (2012: 10.9 years) and of financial liabilities 9.9 years (2012: 10.2 years). According to the Fund's financial and risk management policy this difference may be up to 0.9 years.

Weighted average effective interest on the Fund's borrowings excluding equity was 4.31% at year-end 2013 (2012: 4.29%), but weighted average effective interest on loans at the same time was 4.61% (2012: 4.59%). The difference between interest on the Fund's loans and borrowings increases slightly by 0.005% during the year 2013. The interest margin on loans and the Fund´s borrowings is therefore 0.30%.

Prepayment risk

The financial committee assesses the Fund's prepayment risk and other factors related to interest rate risk and prices it when the Fund's loan interests are decided. In order to reduce even further this risk the Fund also offers loans with prepayment fee but lower interests than loans without such fee. On monthly basis the real proportion of prepayments is measured and estimates for future prepayment proportions are made. On the basis of estimated prepayments the Fund regularly reviews its financing in order to limit the sensitivity of its loan portfolio with regards to interest rates. By means of an amendment to the law on consumer credit in November 2013, new lending to individuals bear a 1% prepayment fee, although the borrower may pay the excess payment of up to ISK 1 million on its loan each year without commission.

Borrowers may in many cases prepay their loans with the Fund without paying a specific prepayment fee. However, the Fund's issued bonds do not include prepayment options, with the exception of house bonds. Therefore, an imbalance between the duration of financial asset and liabilities can arise, which would lead to reinvestment risk for the Fund and thereby interest rate risk.

Around ISK 303 billion of the Fund's loans (2012: ISK 310 billion) is hedged with prepayment fee in part of entirely and prepayable house bonds would the borrower choose to prepay its loan before the end of the loan term. Interest rate and reinvestment risk related to this is considered to be considerable, especially while market interests remain low. The Fund is working on limiting this risk.

CPI-indexation risk

CPI-indexation risk is the risk of fluctuations in the consumer price index (CPI) affecting the fair value and cash flow of indexed financial instruments. The majority of the Fund's loans are indexed, financed with indexed bonds. The indexation risk is mainly due to necessary liquidity according to the Fund's financial and risk management policy. Indexation risk is managed by calculating the sensitivity of the Fund's total balance in indexed assets and liabilities with respect to changes in the consumer price index.

	2013	2012
CPI-indexed financial assets:		
Loans	763.267.389	776.249.859
Treasury securities and other assets	37.108.164	46.102.990
Total financial assets	800.375.553	822.352.849
CPI-indexed financial liabilities:		
Bond issue	834.463.465	849.550.870
Other borrowings	4.093.654	4.605.010
Total financial liabilities	838.557.119	854.155.880
Total CPI-indexation balance	(38.181.566)	(31.803.031)

Indexed liabilities were around ISK 38.2 billion in excess of indexed assets at year end 2013 (2012: ISK 31.8 billion). Based on year-end position and assuming that all other variables remain constant a 1% inflation calculated over a period of one year would have adverse impact on the Fund´s results amounting to ISK 382 million (2012: ISK 318 million).

Financial Statements of the Housing Financing Fund for the year 2013 24 Amounts in ISK thousand

6. Risk management, contd.:

d. *Interest risk, contd.*

Interest-free assets

When the Fund redeems appropriated assets the loan becomes interest-free. At year end 2013, the Fund held 2,606 properties for sale (2012: 2,224 properties) recognised at the value of ISK 37,663 million. (2012: ISK 30,369 million). At year end 2013, the Fund held claims against credit institutions related to the financial collapse in the amount of ISK 3,536 million. (2012: 3,413 million). Interest-free assets amount thus to ISK 41,199 million at year end 2013 (2012: ISK 33,782 million).

e. *Operational risk*

Operational risk is the risk of loss as a result of insufficient internal processes, people and systems, or because of external events, including legal risk. The Fund uses both preventive and supervisory methods to minimise its operational risk. The preventive methods include clear and documented procedures regarding all the Fund's major factors of operations, training of employees, data back-up, access control and other procedures. Head of departments are responsible for management of operational risk in their departments and monitor the operational risk as well as their employees.

f. *Equity and capital management*

The Fund's long-term objective is to maintain an equity ratio over 5.0%. The calculation of the equity ratio is in accordance with international standards (Basel II). If the Fund's equity ratio falls below 4.0% the Fund's Board of Directors shall notify the Minister of Welfare thereof. Furthermore, the Fund's Board of Directors shall propose solutions to reach the long term equity ratio goal.

Equity ratio is specified as follows:	2013	2012
Total equity according to the financial statements	14.845.389	14.699.372
Intangible assets	(151.428)	(147.721)
Equity base	14.693.961	14.551.651
Total equity requirement is specified as follows:		
Credit risk	33.927.452	35.293.987
Market risk	68.108	147.388
Operational risk	460.228	500.228
Total capital requirements	34.455.788	35.941.603
Equity ratio	3.4%	3.2%

7. Cash and cash equivalents and restricted cash

	2013	2012
Unrestricted cash in Central Bank	7.855.259	5.376.201
Unrestricted cash in financial institutions	61.129	5.390.570
Cash and cash equivalents total	7.916.388	10.766.771

8. Treasury securities

Treasury bonds are specified as follows:	2013	2012
Listed treasury bonds at fair value	2.095.623	3.928.200
Treasury bonds without active market capitalised based on amortised cost and initial rate of return	30.198.585	23.976.369
Treasury bonds total	32.294.209	27.904.569

9. Loans to banks

Loans to banks are specified as follows:	2013	2012
Inter-bank loans	7.518.906	10.533.454
Claims on collapsed banks (see note 10)	3.536.000	3.413.000
Loans to banks total	11.054.906	13.946.454

Amounts in ISK thousand

10. Impairment of claims on banks

The Fund had approximately ISK 16,620 million outstanding claims on Iceland's three biggest banks that collapsed in October 2008, resulting from bonds and derivative contracts entered into with the banks. At the same time, the Fund owed to these banks ISK 5,342 million due to derivatives and HFF bonds. A total of ISK 12,628 million has been written down as impairment due to these claims. In the financial statements it is presumed that the Fund has among others the right to off-set these balances. Uncertainty prevails regarding the settlement of claims and derivatives and the Fund's right to off-set these balances. Therefore, the Fund's loss could be different when the final settlement occurs. In the year 2013, one case was concluded based on set-off but other rulings have been issued on cases to which the Housing Financing Fund is not a party regarding related matters. Therefore the Fund has increased its provision for remaining issues. Changes during the year lead to an increase in the total write-down against claims in the amount of ISK 594 million. At year-end 2013, the carrying amount of claims due to matters related to the financial collapse amounted to ISK 3,536 million and is recognised among loans to banks in the balance sheet and recognised debt in the amount of ISK 7,317 million among other liabilities.

11. Financial assets and liabilities

According to the International Financial Reporting Standard IAS 39 *Financial instruments: recognition and measurement,* financial assets and liabilities are divided into specific categories. The classification affects how the relevant financial instrument is measured. Those categories to which the Fund's financial assets and liabilities pertain and their basis of measurement are specified as follows:

- Trading assets and liabilities - are recognised at fair value.
- Loans and receivables - are recognised at amortised cost.
- Other financial liabilities - are recognised at amortised cost.

The following table shows to which group financial assets and liabilities of the Fund pertain and their fair value:

	Trading assets	Loans and receivables	Liabilities at amortised cost	Total carrying amount	Fair value
31 December 2013					
Assets:					
Cash and cash equivalents............		7.916.388		7.916.388	7.916.388
Due from State Treasury................		4.500.000		4.500.000	4.500.000
Treasury securities........................	2.095.623	30.198.585		32.294.209	32.294.209
Loans to banks..............................		11.054.906		11.054.906	11.054.906
Loans..		768.480.860		768.480.860	822.804.839
Total financial assets.....................	2.095.623	822.150.739		824.246.363	878.570.342
Liabilities:					
Bond issues..................................			834.463.465	834.463.465	915.228.318
Other borrowings...........................			4.273.495	4.273.495	4.397.956
Other liabilities...............................			9.364.674	9.364.674	9.364.674
Total financial liabilities..................	0	0	848.101.634	848.101.634	928.990.948
31 December 2012					
Assets:					
Cash and cash equivalents............		10.766.771		10.766.771	10.766.771
Due from State Treasury................		13.000.000		13.000.000	13.000.000
Treasury securities........................	3.928.200	23.976.369		27.904.569	27.904.569
Loans to banks..............................		13.946.454		13.946.454	13.946.454
Loans..		779.095.331		779.095.331	908.805.003
Total financial assets.....................	3.928.200	840.784.925	0	844.713.125	974.422.797
Liabilities:					
Bond issues..................................			849.550.870	849.550.870	1.019.394.810
Other borrowings...........................			4.702.013	4.702.013	5.025.362
Other liabilities...............................			7.111.483	7.111.483	7.111.483
Total financial liabilities..................	0	0	861.364.366	861.364.366	1.031.531.655

Financial Statements of the Housing Financing Fund for the year 2013 26 Amounts in ISK thousand

11. Financial assets and liabilities, contd.

The fair value of loans is estimated by discounting the cash flows of the loan portfolio by using the yield of HFF bonds plus 1.0% spread. The spread reflects the cost of operating the loan portfolio and the credit risk and prepayment risk in the case of loans which do not contain prepayment options.

The fair value of HFF bonds is based on their market price at year-end 2012. The fair value of Housing bonds is measured by discounting the cash flows by using the HFF interest plus 0.5% spread due to lesser liquidity compared to HFF bonds. The fair value of Housing Authority bonds is measured by discounting at the interest of HFF bonds plus 1.0% spread due to liquidity and prepayment risk of those bonds.

Treasury securities that are classified as trading assets are measured at fair value. They are the Fund´s only financial assets recognized at fair value. Fair value is based on quoted prices in active markets for identical assets. Other treasury securities are measured at their yield at acquisition.

12. Net interest income

Interest income	**2013**	**2012**
Interest income on items not at fair value:		
Interest income on loans to customers	64.844.344	72.381.770
Interest income on other financial assets	4.268.000	4.196.327
Government contribution to subsidy interests*	618.521	585.986
	69.730.865	77.164.083
Interest income on items at fair value:		
Interest income on market securities	134.082	303.350
	134.082	303.350
Total interest income	69.864.947	77.467.433

Interest expenses		
Interest expenses on items not at fair value:		
Interest expenses on bonds issued	66.573.802	74.560.002
Interest expenses on other borrowings	344.185	422.584
Total interest expenses	66.917.987	74.982.586
Net interest income	2.946.960	2.484.847

*Subsidy on interests on loans is due to social benefit loans to municipalities and organisations, such as student associations and organisations of disabled.

13. Salaries and salary-related expenses

Salaries and salary related expenses are specified as follows:	**2013**	**2012**
Salaries	656.453	560.388
Pension fund contributions	90.968	78.837
Tax on financial activity	49.156	34.871
Other salary related expenses	70.904	60.232
Other personnel expenses	40.922	34.618
Total salaries and salary related expenses	908.402	768.946

Number of employees of the Fund are specified as follows:

Average number of employees during the year in full-time equivalent units	101	98
Number of employees at year-end	100	94

Financial Statements of the Housing Financing Fund for the year 2013 27 Amounts in ISK thousand

Notes, contd.:

14. Auditors' fee

Remuneration to the auditors´ are specified as follows:

	2013	2012
Audit of financial statements	16.000	16.390
Review of interim financial statements	2.977	5.115
Total auditors' fee	18.977	21.505

15. Other operating expenses

Other administrative expenses are specified as follows:

	2013	2012
Collection fees	210.330	174.845
Operating expenses of housing	119.132	117.196
Operating cost of IT systems	186.350	191.672
Audit and review of financial statements	18.977	21.505
Professional services	157.056	77.561
Price evaluation related to payment difficulty solutions	35.342	47.803
Advertising, promotional material and grants	33.575	19.672
Debtors' Ombudsman	268.244	225.384
Financial Supervisory Authority	60.140	37.196
Credit rating	15.843	26.540
Service fees	26.150	30.980
Other operating expenses	64.817	78.219
Total other administrative expenses	1.195.956	1.048.573

16. Properties held for sale

The Fund had repossessed 2,606 properties at year end 2012 (2012: 2,224). Properties owned by the Fund have increased considerably, mainly in the last three years. Total number of properties held for sale managed by the Fund is specified as follows:

	2013	2012
Number of properties at the beginning of the year	2,224	1,606
Repossessed properties during the year	689	743
Properties sold during the year	(307)	(125)
Number of properties at year end	2,606	2,224

Properties owned by the Fund are divided as follows by geographical area:

Southwest Iceland	881	739
Great Reykjavík area	593	493
South Iceland	369	302
West Iceland	285	267
East Iceland	232	224
North Iceland	173	141
Westfjords	73	58
Number of properties at year end	2,606	2,224

At year-end 2013, 986 properties are in the sales process and at the same time the Fund has entered into short-term lease agreements on 1,307 properties.

Financial Statements of the Housing Financing Fund for the year 2013 28 Amounts in ISK thousand

16. Properties held for sale, contd.:

At year end 2013, 1,307 properties were rented out (2012: 925) or 50.1% of the total number of properties managed by the Fund (2012: 41,6%). Income and expenses on properties held for sale is specified as follows:

Rental income from rented properties	1.316.471	957.819
Cost of properties held for sale	(927.012)	(779.298)
Income in excess of expenses from properties held for sale	389.459	178.521

The costs of real estate for sale in the table above include only the direct incurred costs of the properties cf. property taxes, insurance, maintenance, energy costs and commissions of administrators. If all costs of the reception, operations and enforcement of property sales are to be included then consideration needs to be given to the cost of operating the Fund´s asset division in addition to the division´s share of the Fund´s administrative costs. Operating expenses of the Fund´s asset division amounted to ISK 176.0 million in 2013 compared to 173.6 million in 2012. Revenues exceeded expenses of properties held for sale in the amount of ISK 214 million, if taken into account the costs of the asset division (2012: ISK 5 million).

Properties held for sale at year end are measured at the lower of the cost or net fair value and are specified as follows:

Year-end 2013	**Number of properties**	**Official property value**	**Fair value**	**Book value**
Rented	1,307	23.288.027	22.738.370	21.730.526
In sales process	986	15.074.292	12.694.121	11.752.978
Empty	243	3.616.160	3.331.767	3.259.473
Non-habitable	21	288.600	268.682	237.981
Under construction	49	893.953	893.953	682.271
Total	2,606	43.161.032	39.926.893	37.663.230

Year-end 2012				
Rented-out	925	15.693.847	15.036.622	14.038.498
Empty	939	14.545.008	12.772.885	11.901.454
Non-habitable	324	4.691.522	4.175.381	3.870.954
Under construction	36	642.220	643.451	558.210
Operating expenses	2,224	35.572.597	32.628.339	30.369.116

17. Investment in subsidiary

Leigufélagið Klettur ehf. was established at a Board meeting on 23 January 2013. The initial capital amounted to ISK 10 million and the Fund is the owner of 100% of the shares.

In December 2013 an agreement was concluded between the Fund and Leigufélagið Klettur ehf. for the purchase of 517 properties that the Fund had acquired in debt settlement. The purchase price amounts to ISK 8,184 million and will be financed by borrowing and / or the issuance of bonds in the amount of ISK 5,270.5 million equivalent to 64.4 % of the purchase price. The remainder of the purchase price or ISK 2,913.5 million will be provided by the Fund to the company as a capital contribution. The transfer of purchased properties is 1January 2014 and the company will bear the risk and rewards of the assets from that time. The recording of the transaction in the financial statements is based on that date.

The operations of Klettur do not commence until the beginning of the year 2014 when the company takes over the properties and therefore the share in the company´s equity is not recognized in the financial statements of the year 2013. Also, consolidated statements are not prepared for the Fund and Leigufélagið Klettur ehf. as the operations of the subsidiary are immaterial in the year 2013.

The operations of Klettur ehf. are independent and the company has been appointed a Board of Directors. There are two main objectives with establishing the company. On the one hand to release the Fund´s ownership of the properties and separate the operations of the company from the operations of the Fund. On the other hand, to accommodate the will of the government to increase the supply of housing for lease. The main purpose of Leigufélagið Klettur ehf. is to provide suitable residential accommodation for rent throughout the country, with long-term housing security in mind. The Articles of Association states that the purpose of the company 's operations is the operating and leasing of housing, building, buying and selling residential property to maintain and expand the company, as well as administrating, trading and renovating properties along with lending and other activities related to the operations of the Company. The main purpose of the company´s sale of assets shall be to restructure or streamline its asset portfolio, finance other real estate properties or to strengthen liquidity.

Financial Statements of the Housing Financing Fund for the year 2013 29 Amounts in ISK thousand

18. Operating assets:

Operating assets are specified as follows:

	Fixtures and equipment	Real estate	Total
Cost			
Balance at 1.1.2012	239.873	10.197	250.070
Additions during the year	5.216	0	5.216
Balance at 31.12.2012	245.089	10.197	255.286
Additions during the year	10.568	0	10.568
Balance at 31.12.2013	255.657	10.197	265.854
Depreciation			
Balance at 1.1.2012	166.124	5.556	171.680
Depreciation during the year	12.092	205	12.297
Balance at 31.12.2012	178.216	5.761	183.977
Depreciation during the year	12.166	206	12.372
Balance at 31.12.2013	190.382	5.967	196.349
Carrying amounts			
Balance at 1.1.2012	73.749	4.641	78.390
Balance at 31.12.2012	66.873	4.436	71.309
Balance at 31.12.2013	65.275	4.230	69.505

Property value of real estate at year end 2013 amounted to ISK 8.4 million (2012: ISK 7.7 million) and insurance value amounted to ISK 20.7 million (2012: ISK 20.8 million).

19. Intangible assets

Intangible assets are specified as follows:

	Software
Cost	
Balance at 1.1.2012	351.566
Additions during the year	62.533
Balance at 31.12.2012	414.099
Additions during the year	50.292
Balance at 31.12.2013	464.391
Amortisation	
Balance at 1.1.2012	210.898
Amortisation during the year	55.480
Balance at 31.12.2012	266.378
Amortisation during the year	46.585
Balance at 31.12.2013	312.963
Carrying amounts	
Balance at 1.1.2012	140.668
Balance at 31.12.2012	147.721
Balance at 31.12.2013	151.428

20. Depreciation and amortisation of the year is specified as follows:

	2013	2012
Depreciation of operating assets (cf. note 19)	12.372	12.297
Amortisation of intangible assets (cf. note 20)	46.585	55.480
Total depreciation and amortisation	58.957	67.777

21. Bond issues

The Fund issues housing bonds in four HFF series. The name of each series indicates the maturity year of the series. The bond issues are all inflation-indexed annuity bonds with semi-annual payments. All HFF series carry 3.75% nominal interests. Housing bonds are inflation-indexed annuity bonds with four annual instalments and carry 4.75% - 6.00% nominal interests. Housing bonds are callable. Housing authority bonds are inflation-indexed annuity bonds with semi-annual payments and carry 2.70% - 6.25% nominal interests. The effective interest rate of the issued bonds is 4.31%

Bond issues are specified as follows:

Financial Statements of the Housing Financing Fund for the year 2013 30 Amounts in ISK thousand

21. Bond issues, contd.

	2013	2012
HFF14 bond	12.587.562	23.818.334
HFF24 bond	165.839.992	171.795.356
HFF34 bond	219.404.366	217.859.984
HFF44 bond	385.983.495	378.312.359
Housing bonds (final maturity 2040)	29.090.763	35.392.219
Housing Authority bonds (final maturity 2038)	21.557.286	22.372.618
Total bond issues	834.463.465	849.550.870

22. Other borrowings

Other borrowings are specified as follows:

	2013	2012
Pension funds	1.770.830	2.127.166
Municipalities	2.580	25.163
Insurance fund	279.046	263.858
Callable bonds	179.840	97.002
Unpaid due to purchase of loan portfolios	2.041.199	2.188.824
Total other borrowings	4.273.496	4.702.013

23. Rental agreements

The Fund has entered into a operating lease agreement on the property used in its operations. Minimum lease payments are specified as follows at year end:

	2013	2012
Payable within 1 year	109.551	106.725
Payable after 1 to 5 years	221.122	214.956
Later	85.918	119.726
Total	416.591	441.407

24. Related parties and salaries of management

The Fund has a related party relationship with its owner, board members and executive officers and its subsidiary. The Housing Financing Fund is publically owned and administratively falls under the Ministry and Minister of Welfare. Government institutions and self-governing corporate entities that are financially dependent on the authorities are related parties of the Fund. Loans to related parties are granted on arms-length basis. The balance of mortgage loans to related parties amounted to ISK 46.5 million at year end 2013 (2012: ISK 171 million) and are included in loans in the balance sheet.

Salaries of the Board, Managing Director and key personnel is specified as follows:

	2013		2012	
	Salaries	Pension fund contributions	Salaries	Pension fund contributions
Sigurður Erlingsson, CEO	16.759	1.873	14.598	1.701
Chairman of the Board, Ingibjörg Ólöf Vilhjálmsdóttir	518	52	0	0
Former Chairman of the Board, Jóhann Ársælsson	1.554	179	1.727	199
Former board member, Katrín Ólafsdóttir	0	0	345	40
Other Board Directors, four	4.096	335	3.799	316
Key personnel, eight	89.008	11.521	80.357	10.566

A claim on the Fund´s subsidiary Leigufélagið Klettur amounted to 73,180 thousand at year end 2013.

Financial Statements of the Housing Financing Fund for the year 2013 31 Amounts in ISK thousand

25. Uncertainty in the operations of the Housing Financing Fund and its ability to continue as a going concern

It has been obvious for quite some time that the Fund´s interest rate margin has been insubstantial or only 0.30% which is insufficient to cover the impairment comparable to the impairment resulting from the economic collapse. Therefore, the Fund for the time being has needed support from its owner to achieve once again financial strength.

Serious doubt exists as to the Fund's future role and the possibility of its existence and this volatile state has existed since the Social Affairs and Housing Minister appointed a project committee on the future organization of housing policy on 9 September 2013 in accordance with the resolution on the action plan for household debt relief passed by Parliament last spring. The project management will submit to the Minister proposals for the future role of the Fund in April or May 2014. As a result, strategic decision-making in the immediate environment of the fund has been suspended, affecting the operations of the Fund in various ways.

The government announced plans for principal reductions of mortgages at the end of November. Indexed mortgage loans will be reduced and deductions will be made of earlier measures of reductions benefited by borrowers. The Fund´s managers expect full compensation for the loans that are written down, however implementation of the compensation plan has not been finalized. A bill has been proposed regarding the reductions and is in the process of parliamentary procedure.

In 2013, the Board confirmed the Fund´s policy of achieving full operational sustainability no later than the year 2018. The plan of operations for the year 2014 is to strengthen the Fund´s infrastructure, focusing on risk management and altering the financing of the Fund´s loans. Preparation for new funding categories of inflation indexed and non-indexed is completed and issuance by categories will be determined by liquidity, and by the government´s authorization to issue bonds in new categories, indexed as well as non-indexed. It should be noted that the goal of full operational sustainability is dependent on the Fund´s external environment, the interest and inflation rates, responses of other housing lenders, the Fund´s management, not the least being government´s decisions in certain matters, such as in regards to the Fund´s fees, interest margin, maximum loan amounts and collateral ratios, decisions of state guarantees on the Fund´s obligations, and other decisions arising from laws and regulations.

26. Other matters

EFTA Surveillance Authority

In June 2008, the EFTA Surveillance Authority (ESA) informed the Icelandic authorities that elements of the operations of The Housing Financing Fund entailed State aid and were not in accordance with the State aid rules of the EEA Agreement. Furthermore it was the Icelandic government´s duty to adapt the activities of the Fund to those rules. State aid to the Fund is considered to consist of unlimited state guarantee embodied in the state´s owner guarantee, exemption from taxation and the state as the Fund's owner, has not made claims of returns on the operations of the Fund. This conclusion is based on the fact that the Fund operates in the private sector and its lending is not limited to a clearly defined social role. The Government sent ESA proposals for changes to the future role of the Fund in October 2013. The government's proposals are focused on keeping the role of the Fund basically unchanged but setting certain limits on lending to high-end properties and also stricter requirements for loans to legal entities. The Housing Act has now been amended in order to meet these annotations. ESA has called for further implementation of government restrictions on the Fund´s private lending. The government however, has not finalized the definition of the role of the Fund as a service provider in the public interest and the case remains open as to ESA. Authorities have linked the communications of ESA to the project of the future organization of housing policy to be carried out by a committee of the Ministry.

Project on future organization of housing policy:

In September, the Minister of Social Affairs and Housing appointed a project committee on the future organization of housing policy in accordance with the Congressional resolution on the government action plan for household debt relief passed by Parliament last spring. The policy formulation task of the committee includes presenting recommendations for a new mortgage credit system, which furthermore ensures an active rental market and effective social resources for those in need of such resources. The committee has in accordance with the terms of reference examined models from the other Nordic countries and utilized the work of a committee that has delivered its report on the future prospects and role of the Fund.

The consulting firms Analytics ehf. and KPMG ehf. have submitted a joint report to the committee proposing that the Fund cease completely to grant new loans and management of the current portfolio of loans continues until they expire or the loan portfolio be sold. This proposal is a contribution to a part of the committee´s project and proposals of four expert teams on behalf of the committee. The consultants´ report will be discussed at an upcoming meeting with the committee. It is expected that the committee submit its final proposals on the housing policy in a report to the government in late April.

26. Other matters, contd.

Dispute on validity of Eir´s hypothecation:

A claim was made for the rectification of the property registry relating to alleged errors of the property registry director´s official recording of mortgage bonds secured against 116 properties owned by Eir, thereby releasing the mortgage bonds from the properties. The claim was based on the lack of the approval of the competent authorities for pledging, thereby the registry director was obligated to dismiss the registration of the mortgage bonds. The case has been brought before the court and the Supreme Court released its decision in a judgment of 20 February 2014 in case no. 99/2014. The result was in favor of the Fund as the claim for rectification was denied. The Supreme Court´s ruling was based on the lack of the plaintiffs´ legal standing to claim rectification.

Eir´s total liabilities amount to ISK 8 billion, of which the Fund´s mortgage loans amount to over ISK 3 billion, and pension funds´ loans amount to nearly ISK 3 billion. The Housing Financing Fund has established a provision to address this uncertainty.

Legal action due to indexed loans:

The Fund was cited for violation of the Act on Consumer Credit, challenging the legality of indexed loans in the fall of 2013. The lawsuit was filed in November 2013. The main cause of the action pertains to the Fund not having the authority to collect the costs entailed by the CPI-indexation of the loan as total borrowing costs were not identified in the initial loan process. The Fund requested a motion for dismissal on the grounds of failure to state a valid claim and is currently awaiting the outcome of the District Court dismissal case. It should be noted that the same case was dismissed in April 2013.

The Fund´s Chief Executive Officer was summoned personally in the fall months based on provisions of the Act on Financial Undertakings with regards to the personal liability of employees of financial institutions. The case was dismissed by the court ex officio.

The discussion about the legality of indexation of loans in respect to consumers is prominent and the demand requiring adjustments is considerable. Clearly, if the provisions of the Act on Consumer Credit as to the granting of indexed loans to individuals are ruled illegal, this would lead to enormous losses for the Fund since its assets are essentially all indexed.

Prepayment fee law-suit:

There are quite a number of inquiries and objections from customers regarding the prepayment fee and fee for excess payments. With amendments to the Housing Act no.120/2004 the Fund was granted the authority to offer to its customers loans with lower interest rates, provided that they would relinquish their right to prepay the loan. It is argued that the prepayment fee has not been sufficiently explained to customers and therefore is illegal. A customer of the Fund requested that the fee be cancelled upholding that it was not sufficiently specified in the bond he signed. The Complaint Board for Social Affairs and Housing Matters concluded that the Fund was found to be in compliance with the law as to the collection of the fee. The Fund has been summoned to reimburse the prepayment charge. A statement was submitted in the fall and the case will be conducted before the District Court in May.

There have been complaints regarding the prepayment charge as it is significant given current conditions. The fee is based on the provisions of the Housing Act and is noted on the bond that the loan is unrefinancable except at special rates with reference to the provisions of law in this regard. If the fees are deemed to be illegal due to lack of information to customers, the fund is exposed to prepayments as the Fund does not have the authority to cover its own borrowing against prepayments. The Fund´s loans containing a prepayment clause amounted to ISK 138 billion at the end of the year. If all of these loans would be prepaid, along with customers´ collected prepayment charges, the Fund´s loss based on current interest rates could amount to ISK 10 -11 billion.

Principal Reduction of Mortgages:

The government announced plans for principal reductions at the end of November. A bill on implementing the principal reduction is being drafted and will be presented in the spring of 2014. According to the proposals currently set forth, it is expected that substantial payments will be made on the Fund´s mortgage loans in the first lien position. This will improve the security position held by the Fund but may result in increased prepayment risk and interest rate risk for the Fund. Since the government´s plan has just recently been announced, the Fund has not had the opportunity to analyze the impact of the plan on its performance or financial position in its entirety.

27. Approval of Financial Statements

The Financial Statements were approved by the Board on 31 March 2014.